The Problem of Sieving Related Party Transactions in India and the UK

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Introduction

The rise of family-owned businesses has resulted in the clustering of several companies and their subsidiaries under the control of one family or shareholder.[1] Such concentration of companies, in one hand, has the potential to cause conflicts of interest between promoter entities and minority investors.[2] If the company were to profit, the same would be shared with the minority investors. But if the director/controlling shareholder syphons off the profits to themself or their relative, or to a company where they are a controlling shareholder, they would be able to consume a larger share of the profits. This is undertaken by shifting value from one company to another through self-dealing transactions within the company management.[3]

An atmosphere where RPTs are imbued could be challenging even when they are undertaken in good faith.[4] The corporate governance structure could be negatively impacted by the existence of relationships amongst companies which could impact transactions and disclosure obligations.[5] The existence of such an atmosphere could warrant the presence of expropriation, which means that the profits of a company are either in a position of or are actually being accrued by another entity.[6] For real expropriation to occur, the assets, profits or property should be owned by an entity, but another person or entity would be in possession of them or would be unjustly benefited by them.[7] Such expropriation has the potential to cause huge losses to shareholders, management and beneficiaries of the entity and can also negatively impact the capital market regime of the industry.[8] However, mere appearance or the presence of conditions that enable expropriation could cause damage even without the actual harm, as it would affect inter-personal relationships in the governance structure. These negative perceptions could also negatively impact the country's capital markets regime and further the deterioration of equity markets.[9] Therefore, it is imperative to enforce strong disclosure regulations and transparency requirements to avoid even the pre-supposition of abuse.

The Securities and Exchange Board of India ('SEBI') issued the Sixth Amendment in the LODR Regulations,[10] which has been discussed in the paper. The paper illustrates how the partial transplantation of the English corporate regulation regime in India[11] has resulted in dissonance and inconsistencies, which could cause disinvestment

1 Marianne Bertrand, Paras Mehta, and Sendhil Mullainathan, 'Ferreting Out Tunnelling: An Application to Indian Business Groups' (2002) 117 Q. J. Eco. N. 121, 126.

2 Ami Galani & Nathan Rehn, 'Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses' (2010) 22 Nat'l L Sch India Rev 29, 32.

3 See Lucian A. Bebchuk & Assaf Hamdani, 'The Elusive Quest for Global Governance Standards' (2009) 157 U. PA. L. REV. 1263, 1307.

4 Zohar Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (2003) 91 Cal L Rev 393, 402.

5 Indian Accounting Standard 18: Related Party Disclosures [17].

6 K. S. Thorburn, 'Corporate Governance and Financial Distress' in Hans Sjögren and Göran Skogh (eds), *New Perspectives on Economic Crime* (Edward Elgar 2004).

7 ibid.

8 ibid.

9 OECD, *Guide on Fighting Abusive Related Party Transactions in Asia* (2009) 11-12.

10 Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021 <https://www.sebi.gov.in/legal/regulations/nov-2021/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-sixth-amendment-regulations-2021_53851.html>.

11 Afra Asharipour, 'Corporate Governance Convergence: Lessons from the Indian Experience' (2009) 29 Nw. J. INT'L L. & Bus. 335, 354.

and challenges in the cross-border transactional market. Through the analysis presented herein, the author intends to demonstrate how the current RPT regulation could prove to be insufficient in entrapping RPTs even after the expansion of the scope of related parties and an increase in the materiality threshold. The article examines the genus of RPTs by traversing through the fiduciary duty of directors in both jurisdictions and unjust enrichment whilst presenting the need for the inclusion of more variables whilst computing the materiality threshold of RPTs in India.

I. Tracing the History of Related Party Transactions

The English law on RPTs emerged through equitable precedents, which aligned with the modern statutory rules for company incorporation in the 1840s and 1850s.[12] These principles were instilled only in 2006 when the Companies Act was enforced based on a 'high level' restatement of the precedents which had evolved through history.[13] These precedential rules were based on three essential concepts through which the equitable principles on RPTs evolved: conflict of interest, consent of the beneficiary,[14] and procedural management of the conflict.[15] The concept of conflict of interest helped identify the risk involved in RPTs and transactions between the company and a director directly or indirectly.[16] The genesis of this doctrine rests in the duty to avoid conflicts of interest due to a fiduciary duty that one party owes to the other.[17] English law emphasised the director's fiduciary duty towards the company.[18] However, the duties of shareholders and directors who were also shareholders were regulated later.[19]

Secondly, the beneficiary in such transactions, which is the company, could provide consent to such transactions. This would help in discharging the liability of the director.[20] The board members could give this consent through the procedure laid down in the articles of the company prior to the transaction being effectuated.[21] This feature is inter-linked with the last feature, i.e., procedural management of the conflict.[22] In case the procedure laid in the articles was not followed, the claimant need not bother about the favourability of the terms. However, if the procedure was followed, the court wouldn't interfere with the terms of the transaction.[23]

The requirement for voting was also inherent in the Indian Company laws on RPTs, which were modelled in response to the accounting fraud revealed at Satyam Computer Services[24] in an attempt to acquire two companies that were related to the company's founder chairman.[25] The old Indian Companies Act of 1956, which was replaced by the new Companies Act of 2013, provided for restrictions on RPTs where transactions were directly or indirectly related to the director of a company. [26] It is essential to traverse through the scheme of the old Act in order to truly understand the progress in RPT regulations and the bedrock on which they reside. Further, such analysis demonstrates the presence of loopholes that haven't been satisfactorily rectified in the new scheme.

Section 299 of the 1956 Act required the disclosure of the director's interest to the board of directors,[27] and Section 300 required the director to abstain from voting on such a transaction.[28] However, the requirements in the Act allowed significant loopholes. For example, Section 300 was not applicable on a contract with a public company or its subsidiary if the director was only related to the company in the capacity of a director but did not hold any shares, which made him eligible for a directorship,[29] or he held not more than 2% of its paid-up share capital.[30] Hence, these provisions essentially exempted some transactions where the director or his family had a significant stake due to complicated ownership structures.

Further, Section 295, 301 and 297 also included provisions on RPTs alongside Accounting Standard 18 ('AS 18') issued by the Institute of Chartered Accountants of India.[31] RPTs were defined in AS 18, but they were limited to relationships where one party was controlled by the other.[32] Hence, the disclosure requirements under Clause 49 of the Disclosure and Investor Protection Guidelines, 2000 were not applicable on several RPTs occurring amongst sibling companies within the promoter entity.[33] However, the scope of RPTs has significantly expanded both in India and the UK after the introduction of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021[34] and Financial Conduct Authority's Policy Statement PS19/13.[35]

II. Extent of Fiduciary Duty in India and UK

The director's fiduciary duty in both jurisdictions has been to avoid situations where their duty towards the company conflicted with their personal interests.[36] For example, Lord Cranworth in *Aberdeen*

12 Paul Davies, 'Related Party Transactions: UK Model' in Luca Enriques and Tobias Tröger (eds), *The Law and Finance of Related Party Transactions* (Cambridge University Press 2018) 361-399.

13 ibid.

14 John H. Farrar and Susan Watson, 'Self-Dealing, Fair Dealing and Related Party Transactions—History, Policy and Reform' (2011) 11(2) Journal of Corporate Law Studies 506.

15 Davies (n 12) 362-3.

16 Elizabeth A. Gordon, Elaine Henry and Darius Palia, 'Related Party Transactions and Corporate Governance' (2004) 9 Advances in Financial Economics 1.

17 Robert Flannigan, 'The Adulteration of Fiduciary Doctrine in Corporate Law' (2006) 122 Law Quarterly Review 449, 453.

18 See *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq. 461; [1843-60] All ER Rep 249.

19 Companies Act, 2006, ch. 2.

20 Blair Leahy and Andrew Feld, 'Directors' Liabilities: Exemption, Indemnification, and Ratification' in *Company Directors: Duties, Liabilities, and Remedies* (OUP 2017).

21 The National Archives, *Relationship Between the Duties and the Detailed Rules Requiring Member Approval of Conflicts of Interest, Companies Act 2006* (Explanatory Notes) <https://www.legislation.gov.uk/ukpga/2006/46/notes>.

22 ibid.

23 Davies (n 12) 368.

24 Ajaz Ul. Islam, 'Do Shareholder Activism Effect Corporate Governance and Related Party Transactions: Evidences from India?' (2020) 13(2) Indian Journal of Corporate Governance 173.

25 P. C. Rasheed and T. Mallikarjunappa, 'Related Party Transactions and Earnings Management: An Empirical Examination of Selected Companies in India.' (2018) 17(2) IUP Journal of Accounting Research & Audit Practices.

26 The Companies Act, 1956, No. 1 of 1956, s. 299-300.

27 ibid s. 299.

28 ibid s. 300.

29 ibid s. 300(d)(i).

30 ibid s. 300(d)(ii).

31 Bombay Securities Exchange, Listing Agreement Clause 49, § II(D), Explanation (ii).

32 Accounting Standard 18 (n 5) para 10-11.

33 SEBI (DIP) Guidelines of 2000, s. 6.8.3.2, Explanation I.

34 SEBI LODR (n 10).

35 Financial Conduct Authority, Improving Shareholder Engagement and Increasing Transparency around Stewardship, Policy Statement PS19/13.

36 Companies Act, 2006 (n 19) s. 175 (for United Kingdom) and Companies Act, 2013, s. 184 (for India).

Railway v. Blaikie Bros[37] stated, 'no one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or even can have, a personal interest conflicting, or which possibly may conflict, with the interests those whom he is bound to protect.' Similarly, in the case of Newgate Stud Co. v. Penfold,[38] it was observed that the self-dealing rule wouldn't apply if the purchase of a corporate asset were made without full disclosure by the director's relative, in their own name and not as a nominee of the director. However, the fair-dealing rule would be applicable. The director would have to demonstrate that the transaction furthered the company's success, and this test wouldn't be complete just by 'equating it with the lowest non-negligent valuation'[39]. This duty is enshrined within Section 117 of the 2006 Act, where the director is supposed to disclose to the board if he is in any way interested in a transaction with the company.[40]

The consequences of breaching the fiduciary duty are that the contract would become binding on the company only if it is ratified by the shareholders ex ante or ex post.[41] Further, the director is supposed to account for all the profits accrued by him through the transaction and compensate the company for the damages caused.[42] The Report of the Expert Committee on Company Law in India effectively relayed the fiduciary duties of the directors with respect to RPTs.[43] They include the duty of good faith, fair dealing, and no conflict.[44] The duties include the duty to abstain from voting on conflicted transactions and require adherence to the LODR Regulations, which specify the time and manner of disclosure.[45] The duty to disclose shareholdings in all companies are mentioned under Section 184 of the Companies Act, 2013.[46]

Considering that the directors' fiduciary duties in India correspond to those in the UK, the effective fulfilment of this duty would require effective identification and approval of RPTs. However, the gaps in the Indian framework make identification of such transactions difficult, which in turn causes a disadvantage to the company.

III. The Ambit of RPTs in Both Jurisdictions

The recent amendments in the Indian LODR Regulations have vastly increased the scope of transactions that are now considered RPTs and have come closure to those in the UK. After the sixth amendment in the LODR Regulations, related parties in India include the following:

> '(a) any person or entity forming a part of the promoter or promoter group of the listed entity; or
> (b) any person or any entity, holding equity shares:
> (i) of twenty per cent or more; or
> (ii) of ten per cent or more, with effect from April 1, 2023; in the listed entity either directly or on a beneficial interest basis as provided under Section 89 of the Companies Act, 2013, at any time, during the immediate preceding financial year; shall be deemed to be a related party:'[47]

Further, related parties are also defined under Section 2(76) of the Companies Act, 2013, which include the director's relatives, key managerial person and their relative, firms where the director, manager or their relatives are partner(s), companies where director, manager or their relatives hold positions or own more than 2% of its paid-up share capital.[48] Lastly, any company which is influenced by the directions of said director, manager or relative.[49]

However, the definition of related parties as mentioned in DTR 7.3 and LR 11.1.4, in addition to the above-mentioned categories, also includes a person who was a substantial shareholder,[50] director, shadow director of a listed company within 12 months before the transaction,[51] associates of related parties and persons exercising significant control.[52] Further, these guidelines also mention who qualifies as a 'relative' and detail several human relationships.[53] The laxity that can be noticed in the Indian framework is inherent in the aspect of 'control'. The English concept of Persons with Significant Control[54] is a better tool for assessing which entity exercises control over the body corporate instead of the Indian concept of a promoter and controlling shareholder.[55] This is because a promoter is usually labelled as a person exercising control over the company in the prospectus irrespective of their shareholding as against the role of a promoter in the UK, which is company incorporation.[56] Due to this labelling, persons who aren't in actual control could be held liable for omissions and non-compliance with SEBI LODR Regulations.[57] Therefore, promoters were allowed to re-classify themselves after adhering to the conditions mentioned under Regulation 31A of LODR Regulations, which requires having at least more than 10% of voting rights in the listed company.[58]

This condition prevents the successful reclassification of promoters who have absolutely no control over the body corporate, making

37 (1854) 1 Macq 461 (HL).
38 [2008] 1 BCLC 46.
39 ibid 244.
40 Companies Act, 2006 (n 19) s. 117.
41 *Benson v. Heathorn* (1842) Younge & Coll. Ch. 326; *Great Luxembourg Railway Company v. Magnay* (No. 2) (1858) 25 Beavan 586.
42 *J. J. Harrison (Properties) Ltd v. Harrison* [2002] 1 BCLC 163 (CA).
43 Ministry of Corporate Affairs: India, *Report of the Expert Committee on Company Law* <http://reports.mca.gov.in/MinistryV2/related+party+transactions.html>.
44 ibid 1.
45 Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, No. SEBI/LAD-NRO/GN/2015-16/013, reg. 4(2) (f).
46 Companies Act, 2013, s. 184.
47 SEBI LODR (n 10) s. 3 (I) a. (a).
48 Companies Act, 2013 (n 46) s. 2(76).
49 Companies Act, 2013 (n 46) s. 2(76)(vii).
50 Related Party Transactions: Premium Listing Rules, Release 14, 2021, r. LR 11.1.4 (1) <https://www.handbook.fca.org.uk/handbook/LR/11/1.html>.
51 ibid r. LR 11.1.4 (2).
52 ibid r. LR 11.1.4 (4).
53 Disclosure Guidance and Transparency Rules, Corporate Governance, DTR 7, s. 7.3.2 <https://www.handbook.fca.org.uk/handbook/DTR/7/3.html?date=2022-01-14#D50025>.
54 Companies House, Guidance: People with Significant Control, Department for Business, Energy, and Industrial Strategy <https://www.gov.uk/guidance/people-with-significant-control-pscs>.
55 Securities and Exchange Board of India, *Review of the regulatory framework of promoter, promoter group and group companies as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018* <https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/consultation-paper-on-review-of-the-regulatory-framework-of-promoter-promoter-group-and-group-companies-as-per-securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-re-_50099.html>.
56 *Emma Silver Mining Co. v. Lewis* (1879) 4 C. P. D. 396.
57 SEBI LODR (n 45) reg. 5.
58 ibid. reg. 31A (3)(b)(i).

them liable for acts that should be attributed to controlling shareholders.[59] Section 2 (oo) (ii) of the ICDR Regulations states that control exercised by a director is also considered to be actual control, as against the English Company Statutory Guidance for PSC where directors aren't considered PSCs just because of their role.[60] Therefore, due to the regulatory gap in the Indian concept of 'control', the sieve of RPT Regulations becomes narrow by encompassing a limited number of people as related parties.

IV. Challenges Posed by the Threshold of Materiality

The latest amendment to the LODR Regulations includes a change in the threshold of material related party transactions.[61] Material transactions require shareholder approval to go forward in both Indian and English jurisdictions.[62] Now, transactions exceeding Rs. 1000 Crore or 10% of the annual consolidated turnover (whichever turns out to be lesser) will have to obtain shareholder approval in India.[63] The amendment has been based upon the Working Group Report on RPTs.[64] The Report had recommended the threshold to be 5% of the turnover; however, SEBI increased it to 10%, which would result in the entrapment of lesser transactions as compared to what was originally suggested.

Rule 15 of Meetings of Board and its Powers Rules read with Section 188 of the Companies Act, 2013 propose a test based on a company's 'net worth'.[65] However, Regulation 23(1) of the LODR Regulations did not contain this test post the amendment. The author argues that a test that fails to factor in the net worth, gross assets or profits might fail to provide apt results and, in turn, entrap transactions that either wouldn't have been considered material due to these factors or wouldn't include some transactions which are essentially material.

Hence, a transaction is considered material in the UK if the percentage ratio is 5% or more when one applies the tests detailed in Annex 1 DTR 7 of the Disclosure Guidance and Transparency Rules.[66] There are essentially four tests: the gross assets test, profits test, consideration test, and the gross capital test.[67] These tests are formulas that equip variables like the gross assets of the issuer, profits attributable to the assets, the aggregate market value of all the ordinary shares and the gross capital of the company. The Indian regime only utilises the turnover and the 1000 Crore limit as thresholds for analysing the company's financial standing with respect to the RPT.[68] However, analysis of terms like profitability, sales turnover, asset base, and capital are some of the essentials without which financial capability cannot be aptly assessed.[69] Utilising only one of the factors will not effectively determine the company's performance; hence, at least some of these factors need to be considered whilst computing the materiality threshold in India.[70] Therefore, for an effective and holistic financial analysis, the English related party tests involve variables such as gross assets, indemnities and similar arrangements (which help in comprehending the size of the transaction and using correct data during calculations),[71] the market value of securities,[72] current capital ratio (current liabilities over current assets)[73] amongst others. These variables aid in understanding the capability of a company to meet its financial targets and its general solvency. The importance of factoring in such variables is amply evident in the empirical study conducted by Bărbută-Misu, Madaleno and Ilie, where they demonstrate how swaying financial ratios, could be possible indications of a crisis. For example, the authors analyse the mortgage loan crisis that began in 2006 in the United States and later penetrated into banking networks of the US and European large-credit institutions.[74]

Earlier, the Financial Conduct Authority had proposed to keep the materiality percentage ratio at 25% or more.[75] However, the threshold was lowered due to apparent disagreement in the investment market.[76] This is because FCA concurred with the argument that the issuer's listing category shouldn't adjudicate materiality; rather, it would be better to apply a single formula to all RPTs. Now, the 5% percentage ratio is set, which is consistent with LR 11 for premium listed issuers.[77] Further, the rules also provide for aggregation of all transactions which were effectuated within a twelve-month period of the RPT whilst assessing materiality.[78] When a material RPT undergoes a significant change after getting approved, the change will have to be approved by the board.[79] It will have to comply with disclosure and approval obligations separately. The FCA would regard a 10% increase in the consideration payable as a material change.[80]

The problem of the non-inclusion of different financial factors whilst deciding on the materiality of RPTs works against the principles of unjust enrichment and corrective justice. Furthermore, this results in ignorance of the repercussions of breaching the requirement of gaining shareholder approval under the fiduciary duty. Hence, in

59 Rukshad Davar, Kritika Agarwal and Rahul Datta, 'Should Indian securities law shift focus from promoters to persons in control?' <https://www.majmudarindia.com/insight/indian-securities-law-shift-focus-promoters-persons-in-control/>.

60 Companies House, Statutory Guidance on the Meaning of 'Significant Influence or Control' Over Companies in the Context of the Register of People with Significant Control (2017) r 4.6, 4.10 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/675104/psc-statutory-guidance-companies.pdf>.

61 SEBI LODR (n 10) reg. 3(II)(b) 6th.

62 SEBI LODR (n 10) reg. 3(II)(c) for India and DTR (n 53) s. DTR 7.3.8 (2) for UK.

63 SEBI LODR (n 58).

64 Securities and Exchange Board of India, *Report of the Working Group on Related Party Transactions* (2020) <https://www.sebi.gov.in/reports-and-statistics/reports/jan-2020/report-of-the-working-group-on-related-party-transactions_45805.html>.

65 Companies (Meetings of Board and its Powers) Rules, 2014, r. 15(3)(a)(ii) (India).

66 DTR (n 53) Annex 1 DTR 7.

67 ibid.

68 SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021, w.e.f. 1.4.2022.

69 Panagiotis Liargovas and Konstantinos Skandalis, *Factors affecting Firms' Financial Performance: The Case of Greece* (University of Peloponnese Press 2008).

70 Willy Muturi and Maleya M. Omondi 'Factors affecting the financial performance of listed companies at the Nairobi Securities Exchange in Kenya' (2013) 4(15) Research journal of finance and accounting 99-104.

71 DTR 7 (n 53) Annex 3 DTR 7.

72 DTR 7 (n 53) Annex 6.

73 DTR 7 (n 53) Annex 8.

74 Nicoleta Bărbuţă-Mişu, Mara Madaleno, and Vasile Ilie, 'Analysis of risk factors affecting firms' financial performance—Support for managerial decision-making' (2019) 11(18) Sustainability 4838.

75 Financial Conduct Authority, *Proposals to Promote Shareholder Engagement: Feedback to CP19/7 and Final Rules*, Policy Statement PS19/13 (2019) [1.37] <https://www.fca.org.uk/publication/policy/ps19-13.pdf>.

76 ibid.

77 LR (n 50) r. LR 11.1.10.

78 ibid. r. LR 11.1.11.

79 ibid. r. LR 11.1.7.

80 ibid. r. LR 10.5.3.

essence, the director would be liable to return the profits made in the course of an RPT and indemnify the company but would go undetected. Instead, the profit accrued should be returned due to principles of corrective justice which influences the transactions between individuals and requires the fulfilment of the duty of restitution.[81]

Corrective justice exists without external rules of dissemination of equality.[82] It proposes the existence of equality between parties to a transaction.[83] Unjust enrichment in both jurisdictions involves the term 'unjust' to be supplemented by an act of duress, undue influence, coercion, mistake, or lack of consideration.[84] This essentially means that the lack of the plaintiff's consent or vitiation of the same is the primary contributing factor in the principle of unjust enrichment.[85] Hence, ignorance could also be interpreted as a contributing factor because it depicts the absence and not just vitiation of consent. Therefore, considering the failure to disclose material RPTs, either intentionally or due to regulatory gaps, aids the director or manager or profit on account of the corporate entity, the lack of consent of shareholders fulfils the requirement for unjust enrichment. According to Weinrib,[86] the defendant should undo the unjust transaction and obey the defendant's duty of restitution, which has also been modelled into the Indian and English Laws. This can only be done by creating an effective sieve to filter out material transactions by considering the various financial factors whilst computing materiality.

The number of listed companies trading in the National Stock Exchange in India was 2005 in September 2021,[87] whilst those trading in the London Stock Exchange were 2009 in November 2021.[88] Therefore, the number of companies subjected to RPT regulations in both jurisdictions is approximately similar, making the assessment goal comparable. Hence, the sieve of regulation that would strain out material RPTs should be of a common nature. However, due to the ignorance of various financial factors highlighted above, the orifices in the sieve seem comparably larger, resulting in the non-entrapment of certain material RPTs.

V. Ramifications of the Indian Amendment

Apart from the inconsistencies related to materiality, there are some concerns that can be attributed to the sixth amendment in the Indian LODR Regulations. The amendment now includes transactions undertaken between the listed company and related parties of its subsidiary or related parties of the listed company and the subsidiary, which will come into effect from April 2023.[89] However, there could be ramifications on ongoing transactions, which will now have to be re-classified as material or non-material and would have to repeat the process of prior shareholder approval. Hence, Regulation 23(8) of the LODR Regulations causes the concern of retrospective application of the materiality threshold as it states that, 'All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first General Meeting subsequent to notification of these regulations'.[90] The consequences of this retrospectivity might cause an excess monetary burden to the company as in cases where the shareholders would withhold their approval; the company will have to terminate the transaction. Hence, the agreement which would have given rise to the transaction might penalise the company for breaching the terms of the agreement.

Related party transactions occurring between a listed entity/its subsidiaries and any other entity will have to qualify the purpose and effect test from April 1, 2023.[91] The test states that whichever transaction between the above-mentioned entities has the purpose and effect of causing benefit to the related party will be construed as an RPT.[92] Even though the UK Premium Listing Rules have influenced this provision, the threshold for determining the 'purpose and effect' has not been elucidated by SEBI. Hence, SEBI should purposefully clarify this threshold to avoid practical obstacles.

Additionally, the amendment requires obtaining the approval of the Audit Committee of the listed company to approve transactions between subsidiaries of the company which exceed or equal the Indian materiality threshold.[93] However, as per Section 2(87) of the Companies Act, 2013, these subsidiaries will include foreign subsidiaries.[94] Hence, a problem would arise when the approval of the Indian holding company is needed for effectuating a transaction between several overseas subsidiaries. For example, suppose two English subsidiaries of a company incorporated in India wish to transact, and the deal exceeds the 10% threshold. In that case, the transaction cannot be legally effectuated without the Audit Committee of the holding company's approval.

Further, there would arise a situation of conflict with the English laws if legal rules were to be imposed which are inconsistent with the Indian regime. Hence, complying with the fiduciary duty under Sections 173 and 174 of the English Companies Act, 2006 wouldn't be sufficient. The directors will also have to adhere to the Indian guidelines and the Audit Committee's approval. Therefore, they might lose their independence when their decisions are contrary to the approval/disapproval of the Committee. This, in turn, would stand contrary to the independent legal existence of the English subsidiary who would have a separate board of directors from the holding company, and those directors would have a duty towards the subsidiary only and not the holding company.[95]

Further, in the case of *Vodafone International Holdings v. Union of India*, it was highlighted that 'the legal position of any company

81 Andrew Botterell, 'Property, Corrective Justice and the Nature of the Cause of Action in Unjust Enrichment' (2007) 20 Canadian J L & Jurisprudence 275.

82 Zoë Sinel, 'Through Thick and Thin: The Place of Corrective Justice in Unjust Enrichment' (2011) 31(3) Oxford Journal of Legal Studies 553-554.

83 Peter Benson, 'The Basis of Corrective Justice and Its Relation to Distributive Justice' (1992) 77 Iowa L Rev 515, 540–41.

84 *Lipkin Gorman v. Karpnale Ltd.* [1988] UKHL 12; Indian Contract Act, 1872, s. 68-72.

85 Sinel (n 82) 555.

86 Ernest Weinrib, 'The Normative Structure of Unjust Enrichment' in Ross Grantham and Charles Rickett (eds), *Structure and Justification in Private Law: Essays for Peter Birks* (Hart Publishing 2008) 42.

87 'Business Growth in CM Segment' (*National Stock Exchange*) <https://www1.nseindia.com/products/content/equities/equities/historical_equity_businessgrowth.htm>.

88 Number of companies on London Stock Exchange 2015-2021 (*Statista Research Department*, 11 Jan 2022) <https://www.statista.com/statistics/324547/uk-number-of-companies-lse/>.

89 SEBI LODR (n 10).

90 SEBI LODR (n 45) reg. 23(8).

91 SEBI LODR (n 10).

92 SEBI LODR (n 10) reg. 3(I)(b)(ii).

93 ibid reg. 3(II)(c)(b).

94 Companies Act, 2013 (n 46) s. 2(87).

95 A Guide to Directors' Responsibilities under the Companies Act 2006 [2.15] <https://www.accaglobal.com/content/dam/acca/global/PDF-technical/business-law/tech-tp-cdd.pdf>.

incorporated abroad is that its powers, functions and responsibilities are governed by the law of its incorporation.'[96] The Court also clarified that the control of the parent company's shareholders could not overpower the subsidiary's board of directors as the board owes a fiduciary duty towards the subsidiary only and not the holding company.[97] Therefore, this inconsistency in the application of the Audit Committee's approval would stand contrary to the precedent established in both jurisdictions and might expose Regulation 23 of the LODR Regulations to judicial review due to its extraterritorial application.[98]

The same far-reaching effects on foreign subsidiaries will also be noticed in case of material modifications which will have to be approved by the Committee. Considering SEBI has not clearly defined what would constitute material modifications in RPTs,[99] the Audit Committee might exercise their opinion on the same and reject the material modifications approved in the English jurisdiction, creating another inconsistency. Moreover, SEBI has not excluded transactions that might be the customary business for certain companies and transactions done at an arm's length from the ambit of Regulation 23,[100] increasing the burden on the foreign subsidiary.

Conclusion

Construing the sixth amendment in the LODR Regulations to be applicable only on future contracts and not existing ones could provide a loophole to controlling shareholders who might unjustly enrich themselves before the amendment is enforced. Treating transactions under future contracts and those under pre-existing contracts differently might lead to inequality and discrepancies. Hence, the obligation to gain approval should be applicable on all contracts after the amendment is enforced. The amendment also goes on to include the promoter entity into the ambit of 'related parties'.[101] However, this might prove burdensome for promoters who have been subjugated by this 'permanent labelling' and are not actually influencing investment decisions.[102]

Even though this problem of labelling still subsists, the ambit of related parties has now been expanded. It governs persons holding equity shares amounting to 20% or more (with effect from April 1, 2022) or 10% or more (from April 1, 2023). These include shares held directly or on a beneficial interest basis as per Section 89 of the Companies Act, 2013 and might prove to be a positive step towards inculcating the 'Persons with Significant Control' regime and defining bright lines of control in India. However, the analysis undertaken delves into the cervices of RPT disclosure obligations that are analogous to a sieve. When strained through the sieve, some of these transactions would easily pass without shareholder approval due to gaps in regulations. Therefore, there is a need to reduce the sieve size and ensure adequate filtering and transparency to avoid illegitimate expropriation and unjust enrichment.

96 *Vodafone International Holdings v. Union of India* (2012) 6 SCC 613.

97 ibid.

98 *GVK Industries v. Income Tax Officer* (2011) 4 SCC 36.

99 SEBI LODR (n 45) part C, schedule II, cl. 8.

100 SEBI LODR (n 45) reg. 23(5).

101 SEBI LODR (n 10) reg. 3(I)(a)(a).

102 Twenty First Report of the Standing Committee on Finance (2009-2010) on the Companies Bill, 2009, presented to the Lok Sabha and Rajya Sabha (31 August 2010).